



4B

## CITY COUNCIL REPORT

**SUBJECT:** State Audit

**SUBMITTED BY:** Jennifer Hanson, City Manager

**DEPARTMENT:** City Manager's Department

**DATE:** July 2, 2019

**STRATEGIC RELEVANCE:** Administrative

### **STAFF RECOMMENDATIONS:**

The purpose of this report is to provide an update to City Council regarding the implementation of the State Audit Recommendations.

### **BACKGROUND/INTRODUCTION:**

In May 2018, the California State Auditor initiated an audit of the City of Lincoln at the request of the Joint Legislative Audit Committee. The final Audit Report was issued by the State Auditor on March 21, 2019. The Audit Report included many recommendations that were intended to address deficiencies identified during the audit. To aid with the implementation of the recommendations, staff prepared a high level Audit Action Plan (Attachment A) and the Audit Action Overview Schedule (Attachment C).

The Audit Action Plan and the Audit Action Overview Schedule have been updated to demonstrate the progress that has been made with the implementation of the recommendations. It should be noted that the complexity of some of the audit findings may result in modifications of the Audit Action Plan and the Audit Action Overview Schedule. Staff will continue to keep City Council informed of any schedule changes.

### **CONCLUSION:**

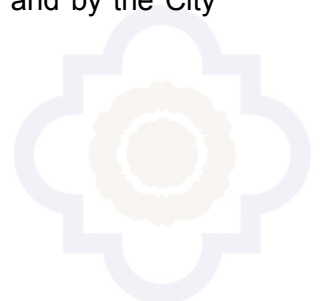
As noted in the updated Audit Action Plan, significant progress has been made on many of the recommendations. Staff completed the required 60 day implementation report to the State Auditor. The next required report to the State Auditor is due on September 21, 2019 (6 months after the issuance of the original report).

### **REPORT ACCOUNTABILITY:**

This Staff Report has been reviewed by the City Attorney for legal sufficiency and by the City Manager for content.

### **ATTACHMENTS:**

Updated Audit Action Plan





**City of Lincoln**  
**Audit Action Plan (Updated July 2, 2019)**  
**Audit Report Issued by the State Auditor on March 21, 2019**

This Audit Action Plan provides the recommendations included in the audit and a summary action plan for the implementation of each of the recommendations. As described below, staff has been diligently working on implementing many of the recommendations prior to the release of the final audit report. The summary action plan is intended to be a summary of the actions needed to implement each of the recommendations and not a comprehensive list of tasks required.

**Summary Recommendation 1:** “To ensure that it complies with state law, Lincoln should immediately review all of its outstanding interfund loans to determine whether the borrowing funds can repay the loans according to the terms. For any loan that is from a restricted fund and that does not have the capacity to be repaid, Lincoln should develop a plan that ensures repayment within a reasonable timeframe, including seeking possible alternative financing or revenue sources, such as the General Fund, bonds, one-time revenues, or a tax increase, to address the obligation.”

**Summary Action Plan:** Based on the Fiscal Year 17/18 audited financials, the City currently has seven outstanding interfund loans (Attachment A identifies the status of the loans based on the last fiscal year). It should be noted that Loan 15 between the Wastewater Enterprise Fund (720) and the Former Redevelopment Agency Fund (284) was written off as bad debt by City Council at the February 26, 2019 City Council Meeting. Additionally, two of the loans are currently being paid by the state because they were debt obligations of the former Redevelopment Agency. It is anticipated at this time that the state will fulfill the obligation to repay the loans in full. The remaining five loans are traditional interfund loans, where one fund is borrowing from another fund.

Staff will review each of the outstanding loans to determine whether or not the loans are consistent with each loan’s adopted agreement and to evaluate compliance with the following:

- The borrowing fund has the demonstrated ability to repay.
- The loan agreement should include a repayment schedule that is reasonable and demonstrates that the loan itself is not interfering with the purpose for which the loaning fund was established.
- The loan agreement should include an interest rate. This is to ensure the loaning fund does not realize negative impacts due to decreased investment revenues being received once the funds are loaned and not invested.
- All interfund loans should be in compliance with the City’s adopted Interfund Loan policy that was approved by the City Council on February 26, 2013 (Resolution No. 2013-030).

Once the analysis is completed, staff will present the analysis to City Council. The full repayment of all associated debt will require a long-term implementation strategy and thoughtful consideration of impact to the General Fund.





**Implementation Update:** The City has initiated the internal review of all interfund loans. Staff is currently in the process of evaluating each interfund loan and preparing a plan for repayment. It is anticipated that repayment proposals will be presented to City Council in August 2019.

**Recommendation 1B:** “To ensure that it avoids accumulating surpluses, by August 2019, Lincoln should establish policies and procedures requiring it to review its fund balances at least annually and, if necessary, reduce its fees within a reasonable timeframe.”

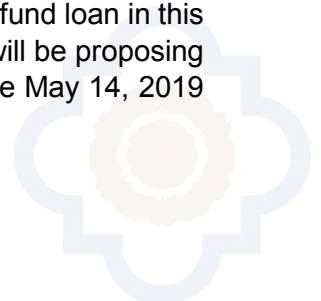
**Summary Action Plan:** Staff is in the process of developing a comprehensive budget policy that will be proposed to the City Council for input at the April 2, 2019 City Council Workshop. The proposed policy will address the evaluation of surpluses and require that all funds be evaluated annually for surpluses during the annual budget approval process. It should be noted that the basis for a surplus determination for any specific fund is dependent on several factors: the reserve policy established for the specific fund, the planned future expenditures, frequency of revenue receipt, and cash flow and contingency requirements. Additionally, there are several funds that will require the establishment of reserve policies.

**Implementation Update:** A Budget Policy was adopted by City Council on April 23, 2019. The Budget Policy includes a requirement to evaluate all funds on an annual basis to determine whether or not a surplus exists. Surplus determination is based on analysis of required reserve levels, planned expenditures, and future capital replacement needs (if applicable). During the Annual Budget process for Fiscal Year 2019/2020, it was preliminarily determined that a surplus exists in Water Funds 710 and 711. Staff is now completing a more in-depth analysis to make further recommendations to City Council on how to address the potential surplus. Additionally, staff is in the process of developing reserve policies for the wastewater, solid waste, source water capacity, and lighting and landscaping district funds. Once completed, the associated reserve policies will be presented to City Council for consideration. The reserve policies will then be used in the future to determine whether or not a surplus exists.

**Recommendation 1C:** “To comply with state law, Lincoln should immediately discontinue its practice of using restricted funds to subsidize other funds that have year-end deficits and lack the ability to permanently repay the transfers within 90 days of the close of the fiscal year.”

**Summary Action Plan:** Beginning with the 2018/2019 fiscal year, the City will discontinue this practice except for short-term loans required for the fiscal year end Generally Accepted Accounting Principle (GAAP) presentation of the City’s financial statements. These types of loans are legal, repaid within 90 days, primarily made for cash flow reasons, and are typically funded by the General Fund.

Full implementation of this recommendation is dependent on formally addressing the Airport’s long-standing negative fund balance. This deficit associated with the Airport has traditionally been addressed at the fiscal year end as a Due to/From transaction, which is a transaction between funds to account for short-term receivables and payables. Accounting for an interfund loan in this manner is not consistent with sound accounting practices. For that reason staff will be proposing a formal interfund loan agreement for the consideration by the City Council at the May 14, 2019 City Council Meeting.





**Implementation Update:** City Council adopted an interfund loan for the Airport Fund 750 debt in the amount of \$4.9 million on June 11, 2019. The General Fund 100 was identified as the lender and Fund 750 the borrower. This interfund loan will replace the Due To/From transaction that has historically occurred in the past to address Fund 750 debt.

**Recommendation 1D:** “By June 2019, Lincoln should establish accounting procedures to ensure that it records all costs of city maintenance from the appropriate funds, including apportioning the general benefit costs to the general fund.”

**Summary Action Plan:** Implementation of this recommendation began on July 1, 2018, with the City Council’s adoption of the Lighting and Landscaping District Engineer’s Report on June 12, 2018. The City is not able to demonstrate full compliance with this recommendation until the fiscal year end due to the fact that the general benefit is an accumulated liability that is not paid by the General Fund until after the close of the fiscal year. The general benefit cost is determined by proportioning the cost of operating and maintaining any improvement paid by the Lighting and Landscaping District between the special and general benefit. Special benefit is the benefit received by the parcel in which the special district assessment is levied, and the general benefit is the benefit received by everyone else that is not included in the district.

No action plan is required to implement this recommendation due to the fact that the work required is already initiated.

**Implementation Update:** Staff began tracking maintenance expenditures by fund and per Lighting and Landscaping District (LLAD) Zones at the beginning of Fiscal Year 18/19. The initial transfer of funds from the General Fund to the LLAD Fund 750 that reflects the cost of the General Benefit and the cumulative zone deficit was completed in June for the fully budgeted cost of the General Benefit and the cumulative zone deficit. This amount will be trued-up at fiscal year-end and modified as necessary. Additionally, the procedures utilized to record all maintenance costs appropriately have been refined and memorialized in a written document.

**Recommendation 1E:** “To ensure that it complies with the state constitution, Lincoln should establish and adhere to procedures that account for revenue and expenditures in each landscaping and lighting zone separately, and it should discontinue the use of surplus revenue from one zone to offset a deficit in another zone. It should take these actions by June 2019.”

**Summary Action Plan:** Implementation of this recommendation began on July 1, 2018, with the City Council’s adoption of the Lighting and Landscaping District Engineer’s Report on June 12, 2018. The City is not able to demonstrate full compliance with this recommendation until the fiscal year end due to the fact that the total deficit of any zone will not be known until the end of the fiscal year. The General Fund will pay the Lighting and Landscaping District for the cumulative costs of all zone deficits and as stated above, the cost attributed to the general benefit. Several of the individual zones within the district have annual expenses that exceed revenues.

It is not sustainable for the General Fund to continue to provide subsidy to these zones, and as such, it is recommended that the deficits be addressed through increased assessments (which requires voter approval) or by decreasing expenses (decrease in services). The general benefit plus the estimated total zone deficit is projected to be \$802,765 for the current fiscal year. Staff is



currently evaluating the viability of a voter approved assessment increase. This initiative is not specifically recommended by the audit and therefore is not included in the Audit Action Plan Overview Schedule.

**Implementation Update:** Staff began tracking maintenance expenditures by fund and per Lighting and Landscaping District (LLAD) Zones at the beginning of Fiscal Year 18/19. The initial transfer of funds from the General Fund to the LLAD Fund 750 that reflects the cost of the General Benefit and the cumulative zone deficit was completed in June for the fully budgeted cost of the General Benefit and the cumulative zone deficit. This amount will be trued-up at fiscal year-end and modified as necessary. Additionally, the procedures utilized to record all maintenance costs appropriately have been refined and memorialized in a written document.

**Recommendation 1F:** “To ensure that city staff provides the city council adequate information to make its decisions regarding interfund loans and transfers, the city council should immediately collaborate with the city manager and department directors to establish formal expectations regarding the content of staff reports, and it should hold the city manager accountable for ensuring all staff reports meet those expectations.”

**Summary Action Plan:** Staff is currently working on a revised staff report template. The purpose of the revisions is to provide greater context to the City Council to ensure that all relevant information is provided to allow for more informed decision making. Staff is specifically recommending adding a policy compliance section to the template and statements of certification for the City Manager, the City Attorney, and the Finance Department.

**Implementation Update:** This recommendation has been implemented. City Council has adopted the new staff report template by Resolution.

**Recommendation 2A:** “Lincoln should immediately commence a fee study that ensures its fees for water capacity are commensurate with the costs of current and planned future water capacity needs. To the extent that Lincoln has previously overcharged for water capacity fees, it should develop a plan to provide equitable consideration to those who overpaid such fees and it should eliminate any unnecessary surplus in the water connections fund.”

**Summary Action Plan:** The implementation of this recommendation began in February 2019 with the issuance of a request for proposal to solicit services from a consultant to assist the City with the completion of the required nexus study. On March 12, 2019, the City Council approved a resolution authorizing a professional services contract with the selected firm. The fee study will be used to inform any nexus for the future use of water connection revenue on hand. If a nexus is not identified, the City Council will then evaluate equitable considerations and the public benefit to determine the appropriate action to address any unnecessary surplus. It should be noted that the timeline for completion included in the Audit Action Plan Overview Schedule may be modified or refined based on the detailed schedule provided the consultant. At the time of writing this staff report, the kick-off meeting for the project has not yet occurred.

**Implementation Update:** The nexus study to complete this recommendation is still underway. Staff anticipates presenting findings to City Council in August 2019.







**Recommendation 2B:** “To ensure that its fees are commensurate with the cost of providing services, Lincoln should develop and follow a timeline by June 2019 for conducting periodic fee studies for each of its services, including updating its staff rates annually.”

**Summary Action Plan:** Various fee studies are currently underway. The timeline for completion was provided to the State Auditor in the City’s response to the audit. This timeline is provided below:

- **Water Rates:** Complete. New rates were implemented October 1, 2018.
- **Solid Waste and Wastewater Rates:** Studies are underway. Draft rates are expected to be presented to City Council by August 2019.
- **Public Facility Element (PFE) Study:** Draft study completed. Final study anticipated to be presented to City Council by **August 2019 (Date Updated)**.
- **Master Fee Schedule:** Contract awarded for preparation of the study on February 26, 2019. Completion anticipated by **August 2019 (Date Updated)**.
- **Cost Allocation Plan:** Contract awarded for preparation of the study on February 26, 2019. Completion anticipated by **August 2019 (Date Updated)**.
- **Water Connection Nexus Study:** Contract approved by City Council on March 12, 2019. **Anticipated August 2019.**

Moving forward, the City will create a schedule ensuring regular updates to its fees and rates. It should also be noted that the detailed schedules for the completion of all of the studies identified above are not included on the Audit Action Plan Overview Schedule because the recommendation was related to development of a timeline. Therefore, the Overview Schedule indicates the tasks to implement the actual recommendation are complete. It should also be noted that the complexity of each study may require minor modification to the anticipated completion dates.

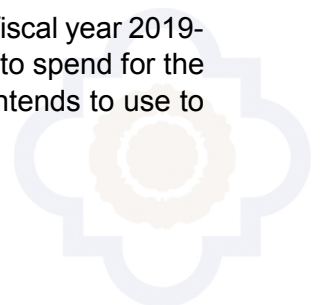
**Implementation Update:** This recommendation has been implemented.

**Recommendation 2C:** “To the extent allowable by law, the city council should develop a plan by August 2019 to provide equitable consideration to ratepayers for the utility costs they incurred that were higher than necessary because of the city’s practice of not paying for its own water, sewer, and solid waste services.”

**Summary Action Plan:** The City Council originally addressed this item at its March 13, 2018 meeting. At the end of that meeting, City Council concluded that any decision regarding the item should be postponed until the completion of the audit. Therefore, it is anticipated that this item will be brought back before the Council for consideration on April 23, 2019.

**Implementation Update:** This item was originally presented to City Council on April 23, 2019. Staff received input and will be bringing this item back to Council for formal consideration In July 2019.

**Recommendation 2D:** “To ensure transparency to the public, beginning with its fiscal year 2019-20 budget, Lincoln should specify in its annual budget the amount that it intends to spend for the use of municipal utilities—water, sewer, and solid waste—and the funds that it intends to use to pay for these costs.”





**Summary Action Plan:** This recommendation will be implemented in the presentation of fiscal year 2019-20 annual budget.

**Implementation Update:** The adopted Annual Budget for FY 2019/2020 implemented this recommendation.

**Recommendation 3A:** “By August 2019, Lincoln should establish and follow policies and procedures for budgeting, preparing its financial statements at the end of each fiscal year, and approving expenditures based on the GFOA guidelines and other best practices.”

**Summary Action Plan:** Staff has already initiated implementation of this recommendation as part of the comprehensive business process improvement initiative:

- On February 12, 2019, the City Council adopted a Closing Policy and a Grants Management Policy
- Staff is currently developing a comprehensive budget policy as part of budget planning for the 2019/20 fiscal year that will be presented to City Council at the April 2, 2019 City Council Workshop.
- Staff has also begun the development of an Accounting and Financial Reporting Policy that will be presented to City Council for consideration.

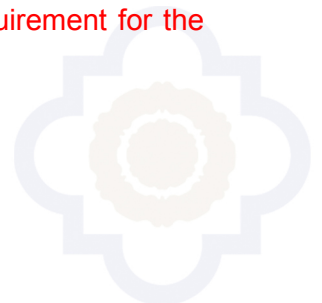
It is imperative that all policies and procedures required by the Governmental Accounting Standards Board (GASB) and its Generally Accepted Accounting Principles (GAAP) are adopted and implemented. Additionally, it will be imperative that appropriate staff receive training on all new policies and that adherence to policies is routinely confirmed.

**Implementation Update:** Since the development of the original Audit Implementation Plan, City Council also adopted the Budget Policy on April 23, 2019. The final policy that will be presented to City Council for consideration is an Accounting and Financial Reporting Policy. This policy has been drafted and will be presented to City Council for consideration during the July 23, 2019 City Council Meeting.

**Recommendation 3B:** “To help ensure that the city manager fully informs the city council of all relevant information before the council approves the annual budget, the city should specify by July 2019 the supporting information that it expects staff to provide with the proposed budget. Lincoln should then update its duty statements to require the city manager and department directors to provide the city council with this information as part of the city’s budget process.”

**Summary Action Plan:** This recommendation will be implemented through the development and subsequent approval of a new budget policy. The proposed budget policy will be presented to City Council at the April City Council Workshop.

**Implementation Update:** The City Council adopted the Budget Policy on April 23, 2019. The Municipal Code and the City Manager Duty Statement already include the requirement for the City Manager to implement and administer City policy.





**Recommendation 3C:** “To ensure that the city complies with its purchasing policy, the City Manager should immediately develop and implement procedures for staff to obtain and document the required approval from the City Manager or the City Council before committing City resources. Beginning immediately, the City Manager should also report to the City Council on a regular basis all purchases that the City Manager approves.”

**Summary Action Plan:** Staff is currently in the process of reviewing the policies and procedures that already exist to determine what modification should be implemented to allow for staff to more easily follow purchasing requirements. The purchasing requirements in the Municipal Code are somewhat difficult to follow and therefore, the development of a straightforward procedure document will facilitate increased compliance. An imperative part of this action plan will be to provide training to staff related to the new procedures. The reporting of purchases approved by the City Manager (those purchase that cost between \$10,000 and \$35,000) will begin on March 26, 2019.

**Implementation Update:** The internal procedures for purchasing have been revised to be more straightforward. The new procedures require documentation that each of the purchasing requirements included in the municipal code are followed. Staff is now in the process of receiving training regarding the new procedures. The reporting of purchases approved by the City Manager began on March 26, 2019 and has continued to be reported on at each formal City Council meeting.

**Recommendation 3D:** “To ensure that the city management holds city staff accountable for resolving deficiencies identified in its annual audits, Lincoln City Council should immediately require the City Manager to track and report progress in addressing outstanding audit recommendations at least quarterly.”

**Summary Action Plan:** This recommendation is very important in ensuring the financial health of the City. It is recommended that this requirement be included in the proposed Accounting and Financial Reporting Policy and that progress be reported to the Finance Investment Oversight Committee and the City Council. Any material weakness in the City’s financial statements should be of great concern to the City Council and to management. It should be noted that there are several existing findings associated with the City’s past financial audits that could take several years to fully address.

**Implementation Update:** The corrective action plan for the 2017/2018 Annual Financial Audit was presented to the Fiscal and Investments Oversight Committee on April 9, 2019 and to City Council on April 15, 2019. An update on the implementation of the corrective action plan will be provided to City Council on July 2, 2019.

**Recommendation 3E:** “By June 2019, Lincoln should develop and follow a process to ensure that it accurately and promptly records all year-end closing entries in its general ledger and issues its CAFR within the period that state law requires.”

**Summary Action Plan:** This recommendation has been completed. The City Council adopted a new Closing Policy on February 12, 2019, which addresses this requirement. The City







acknowledges full compliance will be demonstrated when its books are closed at the end of the fiscal year.

**Implementation Update:** Staff is in the process of preparing for fiscal year-end, which includes the proper recording of all year-end closing entries.

**Recommendation 4A:** “To ensure transparency in providing accurate fee information to the public, Lincoln should immediately update and publicly disclose its master fee schedule to reflect the fees that it actually charges. In addition, Lincoln should periodically review its fee schedule to identify outdated fees that do not accurately reflect the cost of providing services. It should revise those fees to incorporate the costs commensurate with those services and update its master fee schedule accordingly.”

**Summary Action Plan:** The City agrees with this recommendation and began implementation on February 26, 2019, when the City Council approved a contract for services with a consultant tasked with completing a comprehensive update to the Master Fee Schedule and the Cost Allocation Plan. It is imperative that the completion of both the Master Fee Schedule and the Cost Allocation Plan consider full cost recovery to address the ongoing deficits in the Development Services Fund, the Airport fund and to provide additional revenue to the General Fund.

**Implementation Update:** The work on the master fee schedule and the cost allocation plan is almost complete. Upon completion of the draft study, the results will be presented to City Council for consideration.

**Recommendation 5A:** “To ensure that it applies the correct fee credits to developers, Lincoln should develop policies and procedures by September 2019 for establishing fee credits and maintaining adequate documentation to justify modifications to fee credits, including credits it awards based on changes in fee schedules and updated development agreements.”

**Summary Action Plan:** The implementation of this recommendation will primarily be through the adoption of a new Public Facility Element (“PFE”) study. A draft study is completed, and staff desires to present the final study to City Council by June 30, 2019. However, it should be noted that due to the complexities associated with the PFE and current staff vacancies, the presenting of the final schedule may be slightly delayed. Additional procedures are also under consideration for the accounting of these credits to ensure they are accurately tracked and managed.

**Implementation Update:** Staff is still in the process of updating the draft PFE Study. The costs utilized to develop the fees required more updating than originally estimated. It is anticipated that this work will be completed at the end of the summer. City Council adopted the required annual and five year-reporting of developer impact fees per the State Government Code at the June 11, 2019 City Council meeting.

